

ANALYSIS OF AMENDED BILL

Author: Calderon Analyst: Gail Hall Bill Number: AB 692
 Related Bills: See Prior Analysis Telephone: 845-6111 Amended Date: April 2, 2009
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Internal Revenue Code (IRC) Section 382 and Notice 2008-83

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced February 26, 2009.
- FURTHER AMENDMENTS NECESSARY.
- DEPARTMENT POSITION CHANGED TO _____.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 26, 2009, STILL APPLIES.
- OTHER – See comments below.

SUMMARY

This bill provides that California will not follow specific federal guidelines related to treatment of statutory deductions for loss items allowed after an ownership change to a bank.

SUMMARY OF AMENDMENTS

The April 2, 2009, amendments made the following changes to the bill:

- Added legislative finding and declaration No. 8.
- Codified provisions related to conformity to any federal regulation, rule, notice, and other interpretations of federal income tax laws.
- Resulted in two implementation considerations.
- Resolved technical consideration No. 2 discussed in the analysis of the bill introduced February 26, 2009. (See Appendix A).
- Resulted in an additional technical consideration (No. 3).

Board Position:	Legislative Director	Date
_____ S	Brian Putler	04/09/09
_____ NA		
_____ SA		
_____ N		
_____ NP		
_____ O		
_____ NAR		
_____ OUA		
_____ X PENDING		

Except for the THIS BILL, IMPLEMENTATION CONSIDERATIONS, TECHNICAL CONSIDERATIONS, and ECONOMIC IMPACT discussion in this analysis, the remainder of the department's analysis of the bill as introduced February 26, 2009, still applies. Technical considerations No. 1 and No. 3 discussed in the analysis of the bill as introduced February 26, 2009, have not been resolved and are provided for convenience.

POSITION

Pending.

ANALYSIS

THIS BILL

This bill provides the following legislative declarations and findings:

1. The California Revenue & Taxation Code (R&TC) provides for specified conformity to various referenced provisions of the IRC, as enacted as of a specified date.
2. For taxable years beginning on or after January 1, 2005, California conforms to those referenced IRC sections, except as otherwise specifically provided.
3. California conforms to IRC section 382 as enacted as of January 1, 2005.
4. As enacted as of January 1, 2005, IRC section 382 applied to financial institutions, and section 382 included no specific authority for regulatory actions by the Internal Revenue Service (IRS) or the Department of Treasury to exempt banks or other financial institutions from under its provisions.
5. On October 20, 2008, the IRS issued Notice 2008-83 stating that any deduction properly allowed after an ownership change to a bank with respect to losses on loans or bad debts would not be subject to the IRC 382 limitation.
6. Notice 2008-83 constitutes a substantive change to IRC section 382 as enacted as of January 1, 2005.
7. California conforms to IRC section 382 as enacted on January 1, 2005, but the Legislature's action in conforming to IRC section 382 did not contemplate the substantive change in the application of IRC section 382 set forth in Notice 2008-83.
8. On February 17, 2009, President Barack Obama signed the American Recovery and Reinvestment Act (ARRA) of 2009 (Public Law 111-5) that made the following congressional findings:
 - a. The delegation of authority to the Secretary of the Treasury under federal law does not authorize the secretary to provide exemptions or special rules that are restricted to particular industries or classes of taxpayers.
 - b. Notice 2008-83 is inconsistent with the congressional intent of the federal law on loss limitations.
 - c. The legal authority to prescribe Notice 2008-83 is doubtful.

- d. However, as taxpayers should generally be able to rely on guidance issued by the Secretary of the Treasury, legislation is necessary to clarify the force and effect of Notice 2008-83 and restore the proper application under federal "Section 382 limitation" rules following an ownership change.
 - e. ARRA limits the force and effect of Notice 2008-83 to the period beginning with the date the notice was issued and ending on January 16, 2009.
 - f. The congressional findings provide additional confirmation that California did not, and should not, conform to the substantive changes that were attempted to be made by Notice 2008-83.
9. Inasmuch as the Legislature had determined that the changes set forth in Notice 2008-83 are inconsistent with, and in conflict with, the intent of the Legislature in conforming with IRC section 382, the Legislature makes the finding that Notice 2008-83 and any federal regulation providing the same or substantially similar result shall not apply for California purposes and directs FTB to apply that finding for purposes of California Personal Income Tax Law or Corporation Tax Law.

In addition, this bill would authorize the Franchise Tax Board to provide that any federal income tax regulation, rule, notice, or other interpretations of federal income tax laws shall not apply in both of the following circumstances:

- The legal authority of the federal interpretation is doubtful.
- Automatic conformity to the federal interpretation may infringe on the Legislature's authority to make laws involving significant policy issues.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation considerations. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. This bill provides that FTB may determine that any federal income tax regulation, rule, notice, or other interpretations of federal income tax laws are inapplicable for California tax law purposes if legal authority is doubtful or automatic conformity to the federal interpretation may infringe on the Legislature's authority to make laws involving significant policy issues. The terms "doubtful legal authority," "automatic conformity," and "may infringe on the Legislature's authority to make laws involving significant policy issues" are not defined.

The lack of definitions and/or standards for key terms presents difficulties in implementing and administering this bill. The terms "doubtful legal authority" and "automatic conformity" may cause confusion to taxpayers and FTB. In addition, it is unclear what the author means by "may infringe on the Legislature's authority to make laws involving significant policy issues." Without further clarity, it would be difficult for FTB to determine when this circumstance occurs.

2. The language in the bill could be interpreted as limiting FTB's authority under existing law to issue a regulation contrary to an otherwise applicable federal regulation to only the circumstances identified.

TECHNICAL CONSIDERATIONS

The department has identified the following technical considerations. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. On page 2, lines 26 to 30, legislative finding and declaration No. 6 provides that Notice 2008-83, references "financial institutions." Notice 2008-83 makes no reference to "financial institutions," therefore, the author may want to revise the legislative findings and declarations and remove the reference to the word "financial institution" and replace with "bank."
2. On page 3, lines 37 to 39, the operative date language for paragraph (1) should reference "that paragraph" instead of "that subdivision." In addition, paragraph (1) refers to IRS guidance and regulations, yet the operative date language only refers to guidance. The words "and regulation" should be inserted after guidance.
3. The author should consider amending R&TC sections 17024.5 and 23051.5 which deal with the application of federal IRC provisions including federal regulations instead of R&TC section 19503 that deals with California Code of Regulations. If the amendments remain in R&TC section 19503, the amendments should be included in a separate subdivision.

ECONOMIC IMPACT

Revenue Estimate and Discussion

Based on the enactment of Section 1261 of ARRA,¹ FTB staff concludes Notice 2008-83 has no legal effect for purposes of California tax laws, therefore, AB 692 would have no revenue impact with regard to this IRS notice. In addition, this bill amends existing California laws by providing that any federal income tax regulation, rule, notice, or other interpretations of federal income tax laws shall not apply if the legal authority of such federal provisions is doubtful. This provision may impact personal income tax or corporation tax revenue in the future. Because it is not known what IRS notices may be issued in the future, the impacts cannot be determined at this point.

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¹ American Recovery and Reinvestment Act of 2009 (Public Law 111-5), enacted February 17, 2009

APPENDIX A
RESOLVED TECHNICAL CONSIDERATION NO. 2
AB 692 AS INTRODUCED FEBRUARY 27, 2009

The following technical consideration was listed in the analysis of the bill introduced February 26, 2009.

2. The author may want to include in the Legislative findings and declarations that on February 17, 2009, President Barack Obama signed the American Recovery and Reinvestment Act of 2009 (Public Law 111-5), which in part asserts that Notice 2008-83 is inconsistent with the congressional intent in enacting IRC section 382.